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JAPAN'S GOVERNMENT AND PRIVATE-SECTOR RETIREMENT PROGRAMS

Summary

According to a recent survey by the Prime Minister's Office, the aging of Japan's population has accelerated, with annual growth in 1982 only 0.69 percent -- the lowest in postwar history. Data from the Population Problems Research Institute of the Ministry of Health and Welfare puts the ratio of the aged to the total population at 10.4 percent in 1985, rising from 9.5 percent in 1982. As this aging population begins to put pressure on retirement programs, there is an emerging concern over the reserves of both public pension systems and private-sector retirement schemes. The increase in longevity and the early formal retirement age will strain the benefits available under the public pension plan and under the private retirement allowance programs, which have depended on lump-sum payments. Consequently, the wider adoption of company pensions designed to compensate for the financial impact of retirement costs is expected to continue.

The Aging Society

New Population Findings — In 1981 the Population Problems Research Institute of the Ministry of Health and Welfare (MHW) released a revised population projection based on a rapid decline in the fertility rate and new life expectancy figures. The number of births per woman in Japan has dropped sharply, reaching 1.85 in 1976 and declining further to 1.74 in 1980. In 1980 the Japanese life span was 73.5 years for men and 78.9 years for women — an increase of almost 30 years since 1938, when the Ministry of Health and Welfare was established. Estimates put Japan's population (117 million in 1980) at 130 million in 2010, after which it will decline gradually, stabilizing at 118 million by 2075.

These changes indicate that the population 65 and older will increase from 10.6 million in 1980 to a peak of 28 million in 2020. The proportion of the aged to the total

population, which was 9.1 percent in 1980, will gradually increase to 15.6 percent in 2000 — matching the 1980 ratios in European countries (14.9 percent in the United Kingdom, 15.0 percent in West Germany, 13.7 percent in France and 16.2 percent in Sweden). The composition of the aged in the total population will eventually exceed 20 percent (in 2015) and will peak at 22.1 percent in 2045. The working-age population, which is expected to climb until 1995, will taper off, so that instead of 7.5 persons in the working-age group supporting one retired person, by 2000, there will be 4.3 workers in the labor force for every retiree. As is shown in Table 1, Japan will be the oldest society in the world after the year 2010.

Problems Related to an Aging Population — Faced with the prospect of large numbers of departures from the labor force, the government would like to keep as many individuals working as possible, both to keep this group off the unemployment rolls and to reduce pension costs. A survey on employment management by the Ministry of Labor shows a hike in the number of companies that have introduced retirement-age extensions. Although in 1980 only 21.7 percent of all companies retired their employees as late as the age of 60, this figure had risen to 39.5 percent one year later. The government has targeted a uniform retirement age of 60 by 1985 and if this target is to be reached, companies will continue to revise the current seniority-based wage structure under which wages continue to rise with the length of service. Officials say the retirement allowance system, which provides for lump-sum payments that increase with the number of years worked, will also be reviewed.

The rise in the levels of employees retiring will have a substantial impact on pension systems as fewer contributors must support more recipients in the future. The alternatives will be to raise pension insurance premiums, reduce average pension payments, raise the age for pension eligibility, or some combination of these three options. Another age-related issue — medical care for this group — is of increasing concern. According to a report by the Health Ministry, general medical costs for the group 65 and over accounted for almost 33 percent of the national health program's total medical costs of $54 billion. As in all other countries, government-administered health insurance programs are facing large deficits, and these costs will inevitably swell as the aged become a larger percentage of society.

Government Pension Programs

The 1980 pension data used here are based on a 1976 population estimate — the latest available figures. But because of the differences between these figures and new population estimates, the data may provide an overly optimistic view of the financial viability of the pension plans.

Discussions over reforms of the public pension system have concentrated on the impact of higher costs for employee pension payments, given the rise in the number of elderly. Table 2 shows the numbers of contributors and recipients to the Welfare Pension which covers private-sector employees. Contributors will increase from 24.7 million in 1980 to 32.1 million in 2025. Recipients will increase far faster than contributors, however, shooting up from 2 million in 1980 to 11.8 million in 2025. The ratio between contributors and recipients will fall from 12.4-to-1 to 3.0-to-1 by 2010. Economists in MHW calculate that the plan will be in deficit by 1998 and reserves will expire in 2006. The government has taken the position that the difficulties will require an increase in insurance premiums from the present 10.6 percent of monthly income to about 35 percent, and had planned to raise eligibility from 60 to 65 for men and from 55 to 60 for women, although strong opposition has forced a halt to this attempt.

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Table 3 shows the number of contributors and recipients to the National Pension Plan, which provides coverage for all citizens not included in other pension systems. Contributors will increase from 28.3 million in 1980 to 29.1 million in 1995, but will decline sharply thereafter. Recipients will increase from 5.2 million in 1980 to 8.4 million in 2000 and 9 million in 2010. The growth in the number of recipients of the National Pension Plan is smaller than those subscribing to the Welfare Pension Plan, because pension funds have been paid as a transitional measure even though the contributors were not enrolled for the required duration. This is reflected in the ratio between contributors and recipents, which was 5.4-to-1 in 1980, but is expected to fall to 3.0-to-1 by the year 2010 — the same ratio as in the Welfare Pension Plan. The Ministry of Health and Welfare has compared the income-to-payout ratio for the two plans and unlike the Welfare Pension, the National Pension Plan will not go bankrupt, though the size of the reserve will decline.

Official efforts to resolve these problems by government advisory councils, political parties and private research institutes have been numerous. The Nakasone cabinet has issued a statement in conjunction with the government administrative reform proposals of May 1983. The outline, reflecting popular opinion that two parallel systems are wasteful, calls for all public pension plans to be integrated by 1995.

Private-Sector Pension Programs

At present, Japanese companies normally pay retiring workers a lump-sum payment. Part of the amount is tax-free and the remainder is taxed separately from other income at a lower rate. These retirement payments, funded out of current income, represent a growing burden for corporations, which expect that the retirement allowance will triple in the next 10 years. As a result, a large number of corporations have considered reducing the amount paid to employees and/or leveling off the financial burden by introducing private pensions. Rapid growth in private pension funds is therefore anticipated as more corporations prepare for the anticipated rise in retirees and seek to protect the rights of workers entitled to pension benefits.

There are three types of private pension systems in Japan in addition to those administered by the government. The characteristics of the Tax-Qualified Pension Plan, the Adjusted Pension Fund and the Non-Tax Qualified Pension Plan follow:

- The Tax-Qualified Pension, which was inaugurated in 1962, permits corporations to deduct contributions to the pension fund as an expense for tax purposes. Corporations must satisfy certain government requirements and be approved by the Tax Administrative Agency. A minimum tax of 1 percent is paid on the fund's reserves. The management of the fund must be turned over to either a trust bank or a life insurance company. As of March, 1983, seven trust banks, one city bank specializing in trust business, and 20 life insurance companies were authorized to manage these funds. Of the total funds, 66 percent are managed by trust banks and 34 percent by life insurance companies.

- Payments into the second type of plan, the Adjusted Pension Fund, are also tax-deductible. Corporations are permitted to set up their own pension funds as part of the Welfare Pension Fund system, if management of this fund is entrusted to a trust bank or a life insurance company. A special corporate tax is imposed only on that part of the reserve which represents payments larger than pension contributions for government employees. Contributions by employers are deducted from the employee's income (in the case of the tax-qualified pension, the employees bear the full cost of the premiums.

• Non-tax Qualified Pensions are available to persons working for non-profit organizations or self-employed persons who do not qualify for either of the above types of pension plans.

Growth in the volume of pension funds entrusted to trust banks and life insurance companies has been rapid and is still more than 20 percent a year. The total volume of tax-qualified pension plans and adjusted pension funds rose from about $4 billion in 1973 to about $49 billion in 1982 (Table 4). Influencing this surge is the increased emphasis on retirement benefits and the expansion in the number of companies establishing trusts. Some 50 percent of all corporations responding to a survey confirm the trend, explaining that the introduction of pensions will make it possible to budget the costs over a period of years and guarantee employees the benefits of retirement. From management's point of view, the pension system is also attractive because the tax treatment of contributions to externally-managed pension trusts are more favorable than their own pension funds. The Central Labor Relations Commission reports that 75 percent of all pension systems were introduced by management.

For employees, the benefits are obvious and will improve the pension funds both in terms of security and flexibility. Because reserves are entrusted to specialized investment banks and are administered under government guidelines, the principal is secure. Retirees are often permitted to choose whether they prefer a lump-sum payment or a pension. In the case of lump-sum retirement allowances, payment is not guaranteed; employees may not receive an allowance if the company declares bankruptcy.

The Adjusted Pension plans provide benefits until death, while the tax-qualified pension can be either lifelong or for a limited number of years. According to a 1981 survey by the Ministry of Labor, 11.0 percent of corporations have lifetime tax-qualified pensions and 30.4 percent have 10-year pensions. The average monthly pension payment for college graduates was ¥97,000 (about $400), which corresponds to 25.8 percent of the monthly wage.

As Table 4 shows, the growth of funds has been declining. An important factor in this drop is that private pension systems are still immature and began from a very low base. The number of new contributors is expected to slow down considerably because of the large number of companies that have set up pension funds. However, recipients are expected to continue to increase faster than contributors given the immaturity of the pension systems and the growing number of employees who will reach retirement age.

Since the growth rate will still be high, though, payments into the funds will continue to rise. The Mitsubishi Trust Bank estimates that the total outstanding value of tax-qualified pensions and adjusted pensions will increase to $125 billion in 1992 and $167 billion in 1995. As these figures indicate, pension funds have a considerable impact on the financial market. Government guidelines call for a minimum of 50 percent to be invested in assets for which the principal is guaranteed, 30 percent or less in stocks and no more than 20 percent in real estate. A May 1979 authorization allows investment in foreign currency-denominated securities to the extent of 10 percent or less of total assets.

The package of securities has changed in the last decade, with that proportion invested in loans down from over 70 percent to less than 30 percent. The portion of portfolios held in bonds has increased from virtually zero to 40 percent. These shifts represent slowing economic growth and the government's large borrowings, and are expected to continue to attract investors.

As more employees participate in private pension systems, the amount of retirement money paid will rise considerably, and it is possible that the cost of retirement pensions will become a serious issue. Consequently, measures to further stimulate the introduction and enlargement of private pension systems should be considered, and as an incentive, taxes on private pension plans eliminated. The disparity between the taxes on lump-sum retirement allowances and pension payments, analysts agree, should also be corrected.

Conclusion

In planning for the 65-and-over population, it is quite natural that the government pension system will play the more important role. Both the introduction of inflation-adjusted payments in 1973 and the adoption of a more liberal base income estimate raised the level of pension payments. Because recipients are expected to increase, however, it will be very difficult for the government to continue to raise payments. Based on current estimates, the role of the private pension system will become more important as a supplement to public pensions. A report by the general counsel of the Japan Trade Unions calls for a suggested level of pension payments at 60 to 70 percent of pre-retirement income. The Japanese Confederation of Labor says that private-sector payments should cover more than 15 percent of the average income before retirement. Measures to further promote the private pension system may be necessary.

For further information, contact Yoshio Nakamura.

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Table 1: Ratio of Population 65 Years and Older to Working-Age Population

	1950	1960	1970	1980	1990	2000	2010	2020	2025
Japan	8.3%	8.9%	10.3%	13.4%	16.6%	23.3%	29.9%	35.5%	34.6%
Sweden	15.5	18.1	20.9	25.2	26.6	24.9	27.5	32.9	33.6
Italy	12.6	14.2	16.4	20.9	21.8	25.7	27.7	30.9	33.6
W. Germany	14.0	16.0	20.7	22.7	20.1	22.8	28.5	30.0	32.0
Belgium	14.1	16.5	19.0	22.0	22.7	21.9	24.5	27.9	31.2
England	16.0	17.9	20.6	23.1	23.2	23.1	23.3	27.1	29.1
France	17.3	18.8	20.7	21.4	19.7	22.0	21.4	27.0	29.5
USA	12.5	15.5	15.9	16.2	17.6	16.9	17.0	21.9	25.0

Note: Working-age population is defined as those 15-64 years old.

Source: Ministry of Health and Welfare.

Table 2: Contributors and Recipients of Welfare Pension Plan
(in millions)

	Contributors (A)	Recipients (B)	(A)/(B)
1980	24.7	2.0	12.4
1985	26.4	3.3	8.1
1990	27.7	4.6	6.0
1995	29.1	6.1	4.7
2000	30.3	7.7	4.0
2005	31.1	9.1	3.4
2010	31.0	10.5	3.0
2025	32.1	11.8	2.7

Source: Ministry of Health and Welfare.

Table 3: Contributors and Recipients of National Pension Plan
(in millions)

	Contributors (A)	Recipients (B)	(A)/(B)
1980	28.3	5.2	5.4
1985	28.8	6.8	4.2
1990	28.9	7.8	3.7
1995	29.1	8.3	3.5
2000	29.0	8.4	3.4
2005	28.2	8.6	3.3
2010	26.9	9.0	3.0
2025	27.4	8.8	3.1

Source: Ministry of Health and Welfare.

Table 4: Private Pensions Entrusted to Trust Banks and Life Insurance Companies
(in billions of yen)

	Tax-Qualified Pension Plan		Adjusted Pension Fund		Total	
	Amount	Growth	Amount	Growth	Amount	Growth
FY 1970	¥275.8	40.7%	¥187.1	86.4%	¥462.9	56.2%
1971	375.1	36.6	314.8	73.6	689.9	49.0
1972	478.7	27.6	486.5	54.5	965.2	39.9
1973	613.1	28.1	713.7	46.7	1,326.8	37.5
1974	808.3	31.8	1,032.5	44.7	1,840.8	38.7
1975	1,040.1	28.7	1,437.9	39.3	2,478.0	34.6
1976	1,314.8	26.4	1,936.3	34.7	3,251.1	31.2
1977	1,632.8	24.2	2,535.7	31.0	4,168.5	28.2
1978	2,008.2	23.0	3,208.8	26.5	5,217.0	25.2
1979	2,478.4	23.4	3,997.0	24.6	6,475.4	24.1
1980	3,052.3	23.2	4,922.8	23.2	7,975.1	23.2
1981	3,706.6	21.4	6,031.2	22.5	9,737.8	22.1
1982	4,452.0	20.1	7,308.4	21.2	11,760.4	20.8

Sources: Trust Company Association of Japan;
Life Insurance Association of Japan.